



INDEPENDENT FISCAL OFFICE

April 12, 2022

The Honorable Francis X. Ryan
Pennsylvania House of Representatives
149A East Wing, Main Capitol Building
Harrisburg, PA 17120

Dear Representative Ryan:

Thank you for your March 2, 2022 letter that asks the Independent Fiscal Office (IFO) to provide updated estimates for potential property tax replacement revenues. This analysis uses the same data sources and methodologies used to provide previous estimates. The updated tables are as follows.

Table 1 provides the latest IFO baseline for school district property taxes. This baseline was released by the office in November 2021. The IFO estimates that 58% of statewide property taxes are paid by homeowners if all Act 1 allocations are also included. Furthermore, American Community Survey data show that senior homeowners (age 65 or older) remit 30% of property taxes paid by homeowners throughout the state. Therefore, the IFO estimates that senior homeowners paid \$2.73 billion in school property taxes in fiscal year 2019-20.

Table 2 provides updated estimates for potential revenue sources that could replace school district property taxes if they were eliminated. Language for this proposal is contained within House Bill 13. Relevant notes for the estimates are as follows:

- The estimates utilize the latest revenue forecast released by the IFO (January 31, 2022) and long-term projections contained within the IFO's *Pennsylvania Economic and Budget Outlook: Fiscal Years 2021-22 to 2026-27* (November 2021). As with the prior analysis, the estimates should be viewed as approximations only. They do not incorporate effective dates or a compliance phase-in. In addition, the estimates are not reduced for administrative costs, which would likely be significant under this proposal.
- The estimates include the impact of changes in behavior and compliance at full implementation for each of the proposed tax rates.
- The additional sales and use tax (SUT) would be imposed at the local level, similar to the existing local SUT in Philadelphia and Allegheny counties. Unlike the state tax, which is imposed at the point of use, the local taxes are imposed at the point of sale and only apply to purchases originating in those counties. Local tax is not collected on sales shipped into those counties by out-of-state (or out-of-county) sellers. Imposing the tax with the same local situs could materially reduce collections (e.g., -10% to -15%). The projections included in the enclosed table assume the new SUT (including that imposed on food and clothing) is imposed at the state level.

April 12, 2022

Page 2

- The SUT estimates assume that any increase in the SUT rate would coincide with a revenue neutral adjustment to the SUT transfers for public transportation. In other words, public transportation would not receive a funding windfall from an increase in the tax rate.
- The SUT estimates for clothing and food assume that the new 2% tax is only imposed on those items not subject to the current 6% tax.
- The additional personal income tax (PIT) would be collected at the local level, similar to the existing local earned income tax (EIT). The Department of Revenue devotes significant resources to ensure compliance with PIT laws, including the matching of state returns with federal tax data. Since local collectors lack these resources, imposing the tax at the local level would likely reduce collections. The PIT estimates included in the enclosed table are calculated using the current state tax base and assume that the tax would be collected at the state level.
- Under current Pennsylvania law, employee contributions to qualified retirement accounts are subject to PIT, but qualified distributions from those accounts (including employer contributions and earnings) are exempt from tax. If Pennsylvania were to impose PIT on retirement income (excluding Social Security), employee contributions already subject to tax under prior law would be exempt. Under the proposal, contributions to retirement accounts would now be exempt and distributions would be taxable (consistent with federal tax law), Pennsylvania would immediately lose the PIT paid on new employee contributions (tax is now delayed until retirement). These transition issues are incorporated into the Retirement Income forecast (see table) and will resolve over the next 30 to 40 years.

If you have any questions regarding the tables or estimates provided, please do not hesitate to contact my office (717-230-8293). Per the policy of the IFO, this letter will be posted to the office website three days after transmittal to your office.

Sincerely,



Matthew J. Knittel
Director, Independent Fiscal Office

Attachment

Table 1
School District Property Tax Forecast

	Actual	Estimate		Forecast			
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Current-Year	\$14,276	\$14,280	\$14,630	\$15,215	\$15,875	\$16,605	\$17,305
Act 1 Allocations ¹	534	535	535	535	535	535	535
Delinquent ²	506	500	610	620	630	650	680
Total	15,316	15,315	15,775	16,370	17,040	17,790	18,520

Note: Dollar amounts in millions.

1 Actuals through FY 2021-22. Estimated at \$535 million thereafter.

2 Reported by PDE for FY 2019-20. Estimated by IFO thereafter.

Table 2
Options to Fund School District Property Tax Elimination

	Rate	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Additional SUT¹	2.00%	\$3,706	\$4,179	\$4,445	\$4,317	\$4,487	\$4,634	\$4,766	\$4,901
Food ²	2.00%	583	604	626	652	681	705	727	750
Clothing ³	2.00%	232	241	249	258	269	278	286	295
Additional PIT⁴	1.85%	8,019	8,480	9,211	9,639	10,070	10,474	10,900	11,345
Retirement Income⁵	4.92%	1,272	1,338	1,412	1,495	1,583	1,677	1,772	1,865
<i>State Share</i>	3.07%	793	835	881	933	988	1,046	1,106	1,164
<i>Local Share</i>	1.85%	478	503	531	562	595	631	666	701

Note: Millions of dollars. Estimates are long-term and assume an effective date prior to FY 2019-20.

1 New statewide SUT rates would be 8.0%. The new rates for Philadelphia would be 10.0%. The new rates for Allegheny County would be 9.0%. Estimates are calculated using the current state SUT base. The existing local SUTs are point of sale taxes and are only imposed on sales originating in those counties. If the new tax is imposed with the same situs, tax collections will be materially lower (approximately 10% to 15%) because tax would not be collected on e-commerce purchases from out of state sellers. Estimates assume that all transfers from SUT are adjusted to a revenue neutral rate, i.e., special funds do not receive a windfall from the increased tax rate and are not reduced for Department of Revenue administrative costs.

2 Excludes food purchased with Supplemental Nutrition Assistance Program (SNAP) and Women, Infants and Children (WIC) benefits. Assumes foods already subject to the 6% state tax are excluded.

3 Assumes clothing and footwear already subject to the 6% state tax are excluded.

4 New PIT tax of 1.85% calculated using the existing state PIT base. The Department of Revenue devotes significant resources to ensuring taxpayer compliance, including the matching of state returns with federal tax data. Since local collectors lack these resources, actual collections would likely be lower than the provided estimates by an unknown amount.

5 Retirement income tax of 4.92% (3.07% state tax and 1.85% local) net of previously taxed employee contributions and excluding Social Security. Moving forward, assumes that all retirement income will be taxed upon distribution.